

Valuation of RRA Accounts Receivable Report No. 02-10, August 19, 2002

INTRODUCTION

This report presents the results of the Office of Inspector General's (OIG) audit of the valuation of Railroad Retirement Act (RRA) program debt as reported on the balance sheet of the Railroad Retirement Board (RRB) for the fiscal year (FY) ended September 30, 2001.

Background

The RRB is an independent agency in the executive branch of the Federal government. The RRB administers the retirement/survivor and unemployment/sickness insurance benefit programs for railroad workers under the RRA and the Railroad Unemployment Insurance Act (RUIA). These programs provide income protection during old age and in the event of disability, death or temporary unemployment and sickness.

During FY 2001, approximately 700,000 annuitants received benefits totaling \$8.5 billion under the RRA. The RRB also paid \$94.4 million to the 18,000 individuals qualifying for unemployment benefits and the 24,000 individuals qualifying for sickness benefits under the RUIA.

The RRB's balance sheet for the fiscal year ended September 30, 2001 reported net receivables due from the public of \$43.4 million of which 73% were established under the provisions of the RRA.

The debt recovery process begins with the recognition that a benefit overpayment has occurred. In many cases, notice of an event that will affect the benefit payment amount is received after-the-fact. If the corrected rate is lower than the amount actually paid in the past, the beneficiary will have been overpaid. The agency then recognizes a debt in its financial records and takes action to collect the overpayment.

The Bureau of Fiscal Operations has primary responsibility for the RRB's accounting operations. Within the Bureau of Fiscal Operations, the Debt Recovery Section (DRS) has overall responsibility for the RRB's debt collection activities, including monitoring the collection status of pending debt and pursuing delinquent debtors.

The Program Accounts Receivable (PAR) system is a mainframe computer application that supports the agency's debt recovery operations. It contains the detailed history of each debt recognized by the RRB including the cause, amount, collections, outstanding balance, and final disposition.

This study addresses areas of management performance that support the RRB's strategic goal of safeguarding agency trust funds through prudent stewardship.

Objective, Scope And Methodology

The objective of this project was to determine whether the RRB's financial statements reported RRA program accounts receivable at a reasonable estimate of their net realizable value.

The scope of this audit was RRA program overpayments for which the agency reported an uncollected balance as of September 30, 2001.

In order to accomplish this objective, we:

- prepared and analyzed an aging of uncollected debt;
- used statistical sampling to estimate the value of accounts receivable at September 30, 2001; and
- compared the sample estimate with the net value of RRA accounts receivable as reported in the agency's financial statements.

The sampling methodology used in the audit is presented in Appendix I to this report.

This review was performed in accordance with generally accepted government auditing standards as applicable to the audit objectives.

This review of accounts receivable did not include tests of the adjudicative accuracy of the initial overpayment decision. We assessed internal controls only as they specifically related to the conditions identified during the sample review.

Fieldwork was conducted at RRB headquarters during November 2001 through May 2002.

RESULTS OF REVIEW

The RRB's financial statements reported RRA program accounts receivable at a reasonable estimate of their net realizable value as of September 30, 2001.

We selected a random sample of 1,000 accounts receivable with uncollected balances as of September 30, 2001 and estimated the value of each sample item on an individual basis. The audit assessment included consideration of the age and prior collection history of the debt as well as subsequent events such as waiver, write-off or tolerance that might indicate that the amount outstanding would not be collected in full.

Based on the individual account analysis, we estimate that 284 of the 1,000 accounts reviewed, or 28%, would not be fully collected. Our projection of the sample results to the population of all RRA Program debt with an uncollected balance at September 30, 2001, estimated the value of that population at \$30.4 million. This figure compares favorably with the \$30.2 million reported in the agency's financial statements. The sampling methodology and detailed results are presented in Appendices I and II.

Although we have concluded that the allowance for uncollectible accounts reduced the gross amount of RRA receivables to a reasonable amount at the end of FY 2001, we cannot conclude that the methodology used to compute that allowance will produce consistently reliable results in future years. The allowance for uncollectible accounts is presently computed by applying prior collection experience, as recorded in the PAR system, to current receivables. Changes in the agency's debt recognition or record maintenance policies may affect the ability of the present computational method to estimate the agency's exposure to loss from bad debts in future fiscal years.

During our review of sample cases, we identified control weaknesses in the automated systems that support debt recovery that resulted in:

- receivables recognized before a debt had been incurred;
- erroneous receivables; and
- inconsistencies between the debt recovery and benefit payment records.

Our findings and recommendations for corrective action follow.

ARRC Establishes Some Debts Prematurely

The automated system that recovers benefit payments released after the death of an annuitant recognizes some debts prematurely.

The Automated Receivables, Reclamations and Credits (ARRC) system is a mainframe application that identifies benefit payments released after the death of an annuitant. The ARRC system automatically computes overpayments, creates an account

receivable in the PAR system and initiates recovery through the Department of the Treasury's (Treasury) reclamation system.¹

In some death cases, the ARRC system records an account receivable related to a payment that has not yet been released. This action occurs when the notice of an annuitant's death is received after the RRB's instructions to pay the next monthly benefit check have been given to Treasury but prior to the release of the checks. There is a period of approximately seven business days between the time the agency transmits check issue instructions to Treasury and the release of regular RRA annuity checks on the first of the following month.

Accounts receivable arise from claims to cash or other assets.

Prior to release of the benefit payment, the RRB has no claim to cash, only the expectation of a future claim. The ARRC system was designed to facilitate timely identification and recording of overpayments due to annuitant death. The system does not distinguish between overpayments that have occurred versus those that will occur.

Based on the sample result and a supplementary analysis of all outstanding RRA program debt, we estimate that, as of September 30, 2001, the RRB's debt inventory included approximately 1,100 pending reclamations valued at \$1.2 million related to payments that had not yet been released.

The Bureau of Fiscal Operations rejected a prior OIG recommendation to exclude all pending reclamations from its reported accounts receivable.²

Recommendation

1. We recommend that the Bureau of Fiscal operations request that the ARRC system be modified to prevent the premature recording of accounts receivable, or that they exclude prematurely recorded receivables from agency financial reports.

Management's Response

The Bureau of Fiscal Operations agrees with the finding and plans to make an adjustment to exclude these receivables from the RRB's September 30, 2002 financial reports.

The full text of the Chief Financial Officer's response is presented in Appendix IV to this report.

¹Reclamation is a process through which Treasury demands return of a payment from the depositor's financial institution and credits the proceeds to the RRB.

² The OIG had argued that pending reclamations should not be recognized as debts because the agency had not yet identified a debtor against whom to press its claim of recovery. See OIG report number 01-09, July 26, 2001.

The ARRC System Establishes Erroneous Receivables

The ARRC system establishes a receivable for payments released after the death of an annuitant. The RRB should recover only benefit payments to which the deceased beneficiary was not entitled. However, in some cases, the ARRC system erroneously initiates recovery of payments to which the beneficiary was entitled at the time of his/her death.³

ARRC establishes erroneous receivables because it cannot distinguish between payments to which the deceased annuitant had been entitled during his/her lifetime and payments relating exclusively to periods after death has ended entitlement to benefits.

The routine creation of erroneous receivables by an automated system works against economy and efficiency as well as processing accuracy.

Management has advised us that pending changes to the ARRC system are intended to reduce or eliminate erroneous accounts receivable of the kind identified during this review. Accordingly, we make no recommendation for corrective action at the present time.

Management's Response

The Bureau of Fiscal Operations agrees with the finding. In his response, the Chief Financial Officer offered his observation that the number of affected cases is relatively low and currently being corrected manually.

The full text of the Chief Financial Officer's response is presented in Appendix IV to this report.

Some Payment Recoveries Are Not Consistently Recorded

The automated systems that support RRA benefit payment operations do not provide complete, consistent information about returned, reclaimed and cancelled benefit payments.

We compared PAR system reports of returned, reclaimed and cancelled benefit payments with information available in the three benefit payment systems that report historical information: the Payment Rate and Entitlement History (PREH) System; the Tax Accounting (TAX) System; and the Online Cancelled Payment Data (PAYBACK) System.

³ This finding is based on the identification of receivables, initiated by the ARRC system that had been declared erroneous and removed from collection.

Our comparison disclosed that:

- reclaimed checks are recorded only in PREH but not in TAX or PAYBACK systems;
- reclaimed electronic fund transfers are not recorded in PREH, TAX, or PAYBACK systems; and
- checks that have been cancelled by Treasury because they were not presented for payment within 12 months of issue appear in PAYBACK and PREH systems but not in the TAX system.

A summary of the number and monetary value of items omitted from each system during FY 2001 is presented below.

	OMITTED RECOVERIES	
	Number of <u>Transactions</u>	Monetary <u>Value</u>
PREH	2,824	\$2.6 Million
TAX	4,736	\$3.9 Million
PAYBACK	4,659	\$3.8 Million

Financial management systems should collect accurate, timely, complete, reliable, and consistent information. The systems that support RRA benefit payment operations were not designed to provide complete information about returned, reclaimed and cancelled payments:

- TAX, PREH and PAYBACK were developed at different times;
- the TAX system was developed to automate the preparation of year-end tax statements and receives only the data required for that purpose;
- the PAYBACK system processes and displays only the selected Treasury data that was available electronically at the time the system was placed into operation; and
- confirmation of some reclaimed electronic fund transfers has not been automated by Treasury and would require manual data input for recording in any system.

As a result, the systems that support benefit payment operations, individually or as a group, do not provide a complete history of returned, reclaimed and cancelled benefit payments. The inconsistencies across systems create an environment that may be contradictory and confusing to new or occasional users.

During the audit, the OIG proposed modifying the PREH system to include the transactions that are presently excluded. However, because Treasury does not confirm these transactions electronically, each transaction would have to be entered into the PREH system manually.

The Office of Programs believes that the cost of manual data entry would outweigh any benefit obtained by adding the omitted information to the PREH system. They believe that it would be more practical to defer modification of the PREH system until Treasury provides confirmations for these transactions in an electronic format. Unfortunately, Treasury has not announced plans to automate this data.

Accordingly, the OIG will not formalize a recommendation for corrective action at the present time.

Inconsistent Reports of Benefit Withholding

The RRB is authorized to recover outstanding overpayments from benefits currently payable. The agency may withhold a debtor's monthly benefits, in whole or in part, to recover an overpayment.

We identified cases in which the accounts receivable system disagrees with the systems that support benefit payment activities as to the amount of benefits withheld to satisfy debts.

We performed an additional review of the 299 cases in our sample that were currently subject to full or partial withholding. We identified 17 debts (6%) in which the PAR system record disagreed with the benefit payment systems. A list of the exceptions identified is included as Appendix III to this report.

Lack of Direct Interface

In general, the benefit payment systems and the accounts receivable system disagree about benefits withheld to satisfy overpayments because the automated systems that report receivable and benefit payment activity do not communicate directly. An intermediary system controls the amount of periodic withholding recorded in the PAR system and the length of time during which withholding will be recorded.

Changes in the annuity or withholding amount that are recorded in the benefit payment systems after the automated withholding process has been initiated will not be transmitted to the PAR system without manual intervention. Manual processing that does not properly include all affected systems will result in discrepancies.

Special Procedures for Full Withholding Cases

Eleven of the 17 debts questioned by the audit were being recovered by full withholding of the debtor's annuity.

The Office of Programs has reviewed the cases and believes that these exceptions are the result of claims examiners who, contrary to applicable procedure, manually updated

one or more (but not all) of the automated systems for changes in benefit amounts during the period of full withholding.

Current procedure does not provide for the re-computation of benefits that have been suspended-in-full to recover an overpayment. For example, when the full amount of an annuity is being withheld, annuitants do not receive the annual cost-of-living adjustments to which they are entitled. Under these circumstances, when the debt has been fully recovered, the annuity is re-computed, adjustments for all prior periods are applied and any accrued underpayment is disbursed to the beneficiary. These special procedures apply to approximately 500 annuities.

In the cases questioned by the audit, it appears that incomplete manual intervention created discrepant reports of withholding. However, when procedures are properly followed, the PAR record will agree with the benefit payment systems but the amount recorded as a recovery in the PAR system each month may not be the full amount of the beneficiary's entitlement. As long as the debt remains uncollected, the amount outstanding is misstated by design.

Recommendation

2. We recommend that the Office of Programs modify systems, procedures and controls to ensure that the benefit payment systems and the PAR system report consistent, accurate information about benefits withheld in satisfaction of debt.

Management's Response

The Office of Programs generally agrees with the information related to their work. However, they cannot concur with the recommendation offered by the OIG because the resources required to implement such extensive system changes would far outweigh the problems identified in the OIG's report.

The Office of Programs can include the recommended modifications if and when the benefit payment and accounts receivable systems are re-written. However, since they have no specific plans for such an initiative at the present time, they have not provided a target date for system modifications.

The Office of Programs does plan to analyze the cases cited by the OIG and determine a corrective action plan to address similar situations in the future. The focus of their immediate concern is on problems that may cause hardship for their customers. The Office of Programs expects to develop an action plan by April 30, 2003.

The full text of the Director of Programs' response is presented in Appendix V to this report.

SAMPLE METHODOLOGY AND RESULTS

We reviewed a random sample drawn from the population of RRA accounts receivable with uncollected balances as of September 30, 2001.

Sample Selection

Sampling Unit:	One Account Receivable
Population:	Accounts receivable recorded on the PAR system with uncollected balances as of September 30, 2001
Population Size:	11,446 accounts
Population Value:	\$40,410,214
Sample Size:	1,000
Sample Value:	\$3,594,613

Evaluation of the Sample

Uncollectible Accounts:	284
Adjusted Sample Value:	\$2,654,435

Projection of the Sample to the Population

Confidence Level:	95%
Mid-point estimate:	\$30,382,658
Lower limit:	\$26,233,186

Based on the sample results, we can estimate the value of accounts receivable as of September 30, 2001 at approximately \$30.4 million but not less than \$26.2 million.

The details of the OIG's assessment of the collectibility of the 1,000 case sample is presented in Appendix II.

ASSESSMENT OF SAMPLE COLLECTIBILITY

The OIG reviewed 1,000 randomly selected RRA program accounts receivable with an uncollected balance as of September 30, 2001. The audit assessment included consideration of the age and prior collection history of the debt as well as subsequent events such as waiver, write-off or tolerance that might indicate that the amount outstanding would not be collected in full.

Full Collection Appears Doubtful	Sample Items	
Receivable recorded in September 2001 for an October disbursement.	101	10%
Balance includes an erroneous amount.	43	4%
The debt duplicates another PAR entry.	2	
Debt recognized in 1996 or earlier with no collections other than initial reclamations and/or returned checks.	64	7%
The debtor of record is deceased.	42	4%
The debt was recovered prior to October 1, 2001 but the recovery not recorded in the PAR system.	12	1%
Waiver, Tolerance or Write-Off	20	2%
	=====	=====
SUBTOTAL	284	28%
No Evidence to Suggest that Full Collection was not Probable	716	72%
TOTAL	1,000	100%

We reviewed a random sample of 1,000 RRA program accounts receivable with uncollected balances as of September 30, 2001. The sample included 299 cases that were subject to collection by withholding from current, recurring benefits.

For each case, we compared the monthly recoveries as recorded in the accounts receivable system, with the amounts reported as withheld from annuities by the various benefit payment systems, primarily TAX. During this review, we identified 17 debts (6%) in which the PAR system record disagreed with the benefit payment systems.

Sample Item	Type of Withholding	BENEFITS WITHHELD		# Months through May 2002
		PAR System	TAX System	
#542	Accrual	-0-	\$1,579.13	N/A
#665	Partial	-0-	\$73.33	2
#442	Partial	\$85.00	\$0.00	5
#747	Partial	\$105.00	\$0.00	1
#898	Partial	\$157.00	\$0.00	8
#253	Full	\$16.38	\$41.38	32
#269	Full	\$234.80	\$280.90	77
#286	Partial	\$345.02	\$415.44	38
#522	Full	\$68.00	\$70.00	13
#575	Full	\$105.44	\$100.62	68
#686	Full	\$181.00	\$231.00	16
#85	Full	\$60.00	\$69.98	40

		BENEFITS WITHHELD		
Sample Item	Type of Withholding	PAR System	TAX System	# Months through May 2002
#540	Full	\$17.77	\$16.26	56
#628	Full	\$91.08	\$85.47	245
#718	Full	\$10.00	\$93.00	16
#748	Full	\$108.00	\$54.00	15
#726	Full	\$21.99	\$32.99	133



MEMORANDUM

AUG 12 2002

TO : Henrietta B. Shaw
Assistant Inspector General for Audit

FROM : Kenneth P. Boehne *Kenneth P. Boehne*
Chief Financial Officer

SUBJECT: Draft audit report dated July 29, 2002;
Valuation of Accounts Receivable

This is in response to your request for comments on the above draft report. We are pleased that this review states that the net realized value of the Railroad Retirement Act program accounts receivable, reported on the Railroad Retirement Board's (RRB) financial statements as of September 30, 2001, is reasonable. We have expended a great deal of effort to develop our methodology to estimate a reasonable allowance for uncollectible accounts. We understand that many factors can affect this methodology and, as a result, will review the results each year to ensure its reasonableness.

We agree that the Automated Receivables, Reclamations and Credits (ARRC) system records some debts a few days prior to the release of certain monthly benefit payments (which will become overpayments due to the death of the beneficiaries), and will make an adjustment to exclude these receivables from the RRB's September 30, 2002, financial reports (Recommendation No. 1). It should be noted, however, that recovery action is pending for 30 days after these receivables are recorded, and is not initiated until after the payments have been released.

We also agree that the ARRC system records some erroneous receivables for benefits accrued prior to, but paid after, the death of an annuitant. This problem was recognized prior to the initiation of this audit and automated corrective action is in process. The number of affected cases is relatively low and currently being corrected manually.



UNITED STATES GOVERNMENT
MEMORANDUM

AUG 14 2002

TO: Henrietta Shaw
Assistant Inspector General, Audit

FROM: Catherine A. Leyser *Catherine A. Leyser*
Director of Assessment and Training

THROUGH: B. V. Ferguson *B. V. Ferguson*
Director of Programs

SUBJECT: Draft Report - Valuation of Accounts Receivable

OP Response to A/R Valuation Audit

Introduction The Office of Programs reviewed your draft report, Valuation of Accounts Receivable. We generally agree with the information related to the Office of Programs' work, and this memorandum provides specific status of our planned action on the recommendation directed to us.

General Comment We are reviewing the specific cases in which the PAR record differed from the benefit payment system record of the amount being withheld, and are determining if corrective action is necessary.

As you accurately point out there are no direct interfaces between our systems, therefore some discrepancies are possible. While having these systems consistent and accurate in this regard would certainly be an ideal to which we would like to strive, we believe that the resources required to implement such extensive system changes would far outweigh the problems identified in this report.

Recommendation
2

We recommend that the Office of Programs modify systems, procedures and controls to ensure that the benefit payment systems and the PAR system report consistent, accurate information about benefits withheld in satisfaction of debt.

Office of Programs reply:

While we cannot concur with this recommendation, we will take several actions:

Regarding modifying systems to ensure consistency, we can include this as a requirement if and when our benefit payment and accounts receivable systems would ever be re-written as part of our long-range automation initiatives. Since we have no specific plans for this, we will not provide a target date for this long-range initiative and will not expect to keep this as an open recommendation while we are awaiting this.

We agree with the statement in your report that the amounts are misstated by design. For the most part this does not cause undue problems or hardships for our customers, as the appropriate adjustments are made at the point at which the full recovery is made. However, as you point out, we also recognize that there are several situations in which there is a negative impact on our customers. Therefore, we will analyze the cases you found in the review, and determine a corrective action plan to address similar situations in the future. We expect to develop the action plan by April 30, 2003. We would expect to close out this recommendation when the items in this action plan are completed.

cc: Director of Policy and Systems
Chief of Payment Analysis and Systems
Chief of Calculation Analysis and Systems
Director of Operations
Chief of Program Evaluation (Ret/Surv/Medicare/Tax)